

**MINUTES OF THE
PRIVATELY OWNED HEALTH CARE ORGANIZATION TASK FORCE**

Monday, October 10, 2005 – 9:00 a.m. – Room W135 House Building

Members Present:

Sen. Michael G. Waddoups, Senate Chair
Rep. David Clark, House Chair
Sen. Gene Davis
Sen. John W. “Bill” Hickman
Sen. Peter C. Knudson
Sen. Mark B. Madsen
Sen. Ed Mayne
Rep. Stephen D. Clark
Speaker Greg J. Curtis
Rep. Brad L. Dee
Rep. James A. Dunnigan
Rep. Patricia W. Jones
Rep. Bradley G. Last
Rep. Rebecca D. Lockhart

Members Absent:

Rep. Jackie Biskupski

Staff Present:

Constance C. Steffen, Policy Analyst
Allison Morgan, Policy Analyst
Catherine J. Dupont, Associate General Counsel
Patricia Owen, Associate General Counsel
Joy L. Miller, Legislative Secretary

Note: A list of others present, copy of related materials, and an audio recording of the meeting can be found at www.le.utah.gov.

1. Task Force Business

Chair Clark called the meeting to order at 9:10 a.m.

MOTION: Sen. Hickman moved to approve the minutes of the September 22, 2005 meeting. The motion passed unanimously. Sen. Davis, Sen. Madsen, and Sen. Mayne were absent for the vote.

2. Taxation of Health Care Entities

Ms. Steffen distributed and discussed "Major Tax Exemptions Available to Private Nonprofit Organizations." She noted the property tax exemption provided for in the Utah Constitution states that property owned by a nonprofit entity used exclusively for charitable purposes is exempt from property tax. She reviewed the Court's (Utah Supreme Court) interpretation of Utah Constitution Article 13, Sec. 3. She outlined the six factors identified by the Court which must be weighed in determining whether an institution is using its property exclusively for charitable purposes. The Court emphasized that each case must be decided on its own merits, that the six factors are not all of equal significance, and that an institution does not have to qualify under all six factors to be eligible for an exemption. Ms. Steffen reviewed the STC (State Tax Commission) Standards of Practice, which have been upheld by the Court, regarding the criteria which must be met by an institution owning property to qualify for an exemption.

Ms. Steffen explained that the sales and use tax exemption for nonprofits is stated in the Utah Code. Under STC rules, in order to qualify for an exemption from sales tax as a religious or charitable institution, an organization must be recognized by the IRS (Internal Revenue Service) as exempt from tax under Section 501(c)(3) of the Internal Revenue Code. She commented on the corporate franchise and income tax exemption. Section 501 of the IRS Code covers many types of nonprofit corporations and trusts. Two types that exist in Utah are 501(c)(3) which are charitable organizations and 501(c)(4) corporations which

are not organized for profit but operated exclusively for the promotion of social welfare. Organizations exempt under these two provisions within the federal law are exempt from corporate franchise tax in Utah.

Ms. Steffen distributed and explained "Selected Tax Exemptions Available to Entities that Provide Healthcare or Health Insurance or Sell Healthcare Products." She outlined the health care related items that are exempt from sales and use tax as noted in Utah Code Section 59-12-104 and stated that the sales and use tax exemption does not extend to health services. She noted the premium tax exemption is applicable to all health insurance. If a corporation pays premium taxes, it is exempt from corporate franchise tax. Since health insurance is exempt, corporate franchise tax is required.

Ms. Steffen distributed "Intermountain Health Care Tax Status." She referred to IHC Health Plans which indicates that a 501(c)(4) IRS application is pending. Once IHC Health Plans qualifies as a 501(c)(4) entity and receives the federal tax exemption, it will then be exempt under Utah Code because 501 corporations exempt under federal tax law will be exempt from corporate franchise tax. She noted that BC/BS (Blue Cross/Blue Shield) is a 501(m) corporation and is not exempt from corporate franchise tax.

Ms. Lynn Solarczyk, State Tax Commission, explained that the premium taxes are imposed on gross premiums as paid by the insurer. It is a much lower rate than the corporate franchise tax which is imposed at a 5 percent rate and on net profits. STC auditors have compared the two taxes and felt that, in the aggregate, they are basically the same.

Rep. Dunnigan asked how much BC/BS paid in corporate franchise tax.

Ms. Solarczyk indicated she did not have that information and due to confidentiality purposes would not be able to share it.

Ms. Jennifer Cannaday, BC/BS, responded to questions from the Task Force. She explained that BC/BS plans operate independently of one another. All of them are licensees of the national BC/BS Association and contract to use the trademarks. BC/BS of Utah has a local board of directors, appointed by the corporation, that governs the operations in Utah. Any revenue the corporation makes is reinvested back into the company for the benefit of consumers. She commented that BC/BS of Utah used to be the insurer of last resort. It had no underwriting guidelines and no criteria for accepting individuals. When other insurers started entering the market and the risk population began to be segmented, the BC/BS plans could no longer serve as insurers of last resort in their own states. The IRS in the 1980s rewrote the code and eliminated the tax exemption that used to exist for the BC/BS companies and created the 501(m) level, where they remain nonprofit but pay taxes at both the state and federal level. She also indicated that BC/BS pays out millions of dollars in claims every year and is required to keep a 2-3 month payout on its books. Ms. Cannaday stated she would research the history of the information requested regarding the board of directors, disbursement of profits, reserve requirements and how much in excess BC/BS is currently holding, the amount of corporate franchise tax BC/BS paid, and the corporation's 501(m) status and report back to the Task Force.

Mr. Randy Gibbs, BC/BS, reiterated that any profit stays with the company and is regulated by the state Insurance Department. BC/BS has paid the alternative minimum tax rate of 20 percent in federal tax and

a franchise tax rate of 5 percent of taxable income. He noted that during the last fiscal year, the net income was approximately \$18 million.

Mr. Neal Gooch, Deputy Insurance Commissioner, explained that the formula for determining the reserve requirements is based on risk-based capital. Generally to be considered in sound financial condition, the department requires companies to have 2 ½ times the established authorized control level in reserve. BC/BS is operating at 400 percent above the authorized control level. There is no set limitation in the statute regarding a cap. It is based on reserve and exposures being experienced and must be calculated by actuaries. He noted that annual statements filed with the department are public information.

Chair Clark requested that Mr. Gooch provide the percentage of revenue in the top ten insurance companies that went to administrative costs. Rep. Dee requested the calculations on reserve of the entities as it deals with incurred but not reported claims and individual risk.

Mr. Greg Poulsen, IHC (Intermountain Health Care, Inc.), said the state's Insurance Department has done a great job in balancing an appropriate level of reserves so that organizations operating in the state maintain solvency. The formula used works well and serves the people of the state well.

Mr. Doug Hammer, IHC, clarified that the tax status of IHC and IHC Health Services Inc. are 501(c)(3) organizations. Property tax exemptions for hospital properties are reviewed annually by county boards of equalization. In 1984, IHC Health Plans was initially granted a Section 501(c)(3) exemption. Two companion organizations, IHC Care and IHC Group, submitted applications for 501(c)(3) organizations which were pending for years. In 1999, the IRS decided to revoke the 501(c)(3) exemption of IHC Health Plans. IHC decided to litigate the revocation. The position of the IRS was based, in part, on how a health plan pays its primary care physicians. The case went to the United States Tax Court which denied the 501(c)(3) exemption. IHC appealed to the 10th Circuit Court of Appeals which denied it. Mr. Hammer explained that in trying to determine standards to apply for exemption for nonprofit HMOs, the Tax Court applied the exemption standards of hospitals to health plans, which don't fit well. It narrowed the exemption criteria for all nonprofit HMOs as 501(c)(3) entities in the U.S. IHC filed an application for a 501(c)(4) exemption. When the litigation was completed, the IRS determined it would go through the rulemaking process on portions of Section 501(m). The IRS after very carefully scrutinizing the exemption of IHC Health Plans has granted a 501(c)(4) exemption which will be retroactive back to its beginning date. However, the determination letter has not yet been received.

Mr. Poulsen and Mr. Hammer responded to questions regarding physicians providing services in IHC hospitals, particularly in rural areas. Mr. Hammer commented that the hospital governing board is liable for credentialing a physician who is unqualified. That is the only basis on which a physician is denied medical staff privileges at an IHC hospital. Mr. Poulsen said there is openness in all medical staffs throughout the state and that the standard is applied consistently by impartial individuals.

Mr. Merrill Gappmeyer, IHC, stated that the board members at the local level are the ones that have the final say in that area. No one who is qualified is denied the opportunity to practice at IHC facilities.

Rep. Dee stressed the importance of access to quality health care. He commented on the need to look at

the quality of health care and the physicians that are available to these panels.

Rep. Lockhart requested that the Task Force hear from the Utah Medical Association regarding physician access.

Chair Clark turned the discussion to Agenda Item 1 to determine a procedure to review "Utah Health Care Markets" proposals. Rep. Lockhart, Rep. Dee, Sen. Davis, and Sen. Knudson volunteered to participate with the cochairs and staff to review the proposals that are received.

3. Request for Proposals (RFP)

Ms. Steffen distributed 09/08/05 Draft RFP "Analysis of Operation and Practices of the Non-Profit Vertically Integrated Health Care System in Utah." Chair Clark stated the RFP deals more with financial aspects than business practices. The Task Force reviewed the purpose statements as outlined in the RFP. Some of the issues raised in the task force discussion include:

- review of the business practices of IHC;
- should some of the tax benefits or exemptions given to nonprofit organizations be extended to for-profit organizations for the purpose of lowering health insurance costs and improving the price of health insurance;
- address the issue of health plans;
- address advantages in the marketplace and additional burdens a taxable entity would have in the marketplace;
- determine who owns IHC;
- tax status and other financial information for IHC and other health insurance providers;
- how much of a premium dollar is going to taxes;
- how can other insurers in the state be moved to a level playing field; and
- is there cross-subsidization within IHC hospitals.

MOTION: Sen. Hickman moved to change the language in paragraphs 1) and 2) under Purpose of Request for Proposals as follows:

"1) determine the extent to which the nonprofit hospitals and 501(c)(4) insurance plans owned by Intermountain Health Care, Inc. (IHC) have an advantage or disadvantage due to their tax exempt status as compared to for-profit hospitals and other insurance plans in Utah;

2) evaluate the operations and activities of IHC and its applicable nonprofit subsidiaries to determine whether the operations and activities are significantly different from for-profit health care systems in the state;"

SUBSTITUTE MOTION: Rep. Lockhart moved to go to the next item on the agenda. The motion failed with Sen. Davis, Sen. Hickman, Sen. Knudson, Sen. Mayne, and Sen. Waddoups voting in opposition.

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The Task Force voted on Sen. Hickman's motion which failed with all House members voting in opposition. Rep. S. Clark and Rep. Jones were absent for the vote.

MOTION: Sen. Davis moved to adjourn the meeting. The motion passed unanimously.

Chair Clark adjourned the meeting at 1:00 p.m.